

STRATEGY OF ISLAMIC BANKING ORDER

By Dr. Beşir HAMİTOĞULLARI*

Introduction

The ultimate purpose of this paper is to design a conceptional framework for Islamic Banks. I am going to indicate the banking order of Islamic economic system. It is important to identify the keys of economic philosophy of Islam and hence to explain some basic economic, philosophic principles of Islamic System and Banks.

Islam is not a religion in the limited sense of the word but rather "a complete way of life and culture in the light of values and principles revealed by God for man's guidance."

The Islamic concept of development has a comprehensive character and includes moral, spiriritual and material aspects.

What are the objectives of Islamic economical System? All the 'indicators' of Islamic economical System mentioned above unmistakably point to the human economic philosophy of Islam, whose kingpin is al-Adl wal-Ahsan. The Holy Qur'an is explicit on what the individual and the society should be doing:" Lo! Allah en joineth Justice and Kindness (al-Adl wal-Ahsan)" (16: 90). These two basic attributes of Islam translate into an economic system which explicitly aims to establishing a delicate balance between social and economic forces, with a clear 'bias' in favour of the poor and the economically weak. The Holy Qur'an explicitly lays down the ultimate requirement that Islamic policy must meet:" And We desired to show favour into those who were oppressed in the earth, And to make them examples and make them the inheritors, and to establish them on earth..." (28: 5-6) In fact, according to the Holy Qur'an, the poor of the society have a right to the wealth of the rich: And in their wealth the beggar and the outcast (i.e. destitute) had due share" (51: 19). Two points should therefore be crystal clear about an Islamic economic system:

* Prof., Faculty of Political Sciences, University of Ankara.

1) It must enforce a balance —‘equilibrium’— among the consumption, production and distribution relations in the society. This must come about by virtue of God’s commandment to establish al-Adl (justice), and...

2) The second part of God’s commandment i.e.al Ahsan-requires that economic policies in Islamic economy have a distinct tilt towards the poor. Not only that: the proces of pushing up the poor along the scale of social hierarchy must continue until the “oppressed” in the land finally attain a ‘respectable’ status in the society.¹

I. ISLAMIC BANKING ORDER

There is a consensus among Muslim scholars that Islam’s is a “complete” system. Its clear perception of the Unity of all life processes-social, economic and religious-is Islam’s origianl contribution to civilization, and offers the best hope to the Muslims to reorder their socio-economic affairs according to the tenets of Islam...²

When we think an Islamic economic system we are obliged to visualise it in the context of, or in comparison with, the existing international economic order. This is inevitable, while the Islamic order is still in the process of evolution, the existing international economic order dominates the world. In comparing one with the other the most common understanding about how they differ from each other is that one is **RĪBA** (Interest) free and the other is RĪBA-oriented.

This understanding is the result of oversimplifying the concept of an Islamic financial system or the Islamic economic order. It does not mean, however, that the elimination of riba by itself is a very simple proposition, or that its automatically convert a non-Islamic one, or the present international economic order into the Islamic order in the real sense.

The Islamic economic order is based on a set of principles enunciated explicitly in the **QURAN**. This philosophy provides what can be understood as the Islamic system of social justice. No matter what aspect of Islamic economic order is introduced, for practical operations it has to base itself in the **QURANIC** concept of justice.

¹ Syd N. H. Naqvi, H.U. Beg, Rafiq Ahmet, M.M. Nazeer: Agenda for Islamic Reform., May, 1980, Pakistan Institute of Development Economics, Islamabad.

² An agenda for Islamic Economic Reform (by: Syed N’awab Haider Naqvi, H.U. Beg. Rafiq Ahmed, Mian M. Nazeer.), May, 1980, p: 1, Pakistan, Inst., of Devel., Econ., Islamabad.

There is a great agreement among thinkers of Islamic economics that there are two keys to economic philosophy of Islam: One related to real or ultimate owner of earth and the other related to the relationship between man and the real owner. These two basic principles are stated first. Both of them constitute the conceptual foundation of Islamic economics and hence Islamic Banking.

"The Islamic financial system, therefore, cannot be introduced merely by eliminating *riba* but adopting the Islamic principles of social justice and introducing laws, practices, procedures and instruments which help in the maintenance and of justice, equity, fairness and human considerations.³

Every society needs some mechanism through which savings are channelled from savers to investors, on the basis of some understanding regarding repayment and returns. Banking, being the most important sector of any financial system, also has the same priority in Islamic financial operations.

Islamic banking is based on two cardinal principles laid down in the shariah: Prohibition of interest⁴ and its replacement by profit-sharing wherever feasible and desirable.⁵ Though its consequences are revolutionary, the change involved is simple.

Before discussing the basis and strategy of Islamic banking, a distinction should be made between the two approaches to the concept of usury-free banking.

1. **The first approach** is the micro-approach which limits Islamic reorientation to any existing non-Islamic banks alone. This approach does not take into consideration the need for the complete Islamicization of a society and its institutions; therefore, corrupt or unethical practices in the existing socio-economic systems are allowed to continue. Additionally, most so-called Islamic banks in Muslim and non-Muslim countries coexist with Capitalist economic and financial institutions, implementing the micro-approach to Islamic banking.

2. **The second approach** is the macro-approach, which visualizes usury-free banks as an integral part of an Islamic society.

³ Muazzam Ali: "Islamic banking comes of age", in *Economics Banking, Arabia*, August, 1985, p. 60.

⁴ "Allah has permitted trade and forbidden interest", The QURAN, II: 275.

⁵ M.N. Siddiqi: *Shirkat aur mudarabat ke shar'i usul*, Islamic Publications, Lahore, 1961.

The Islamic Plan covers all social and economic aspects, and the required institutional support, and conforms to the needs of a way of life based on Islamic rules and regulations.

The main objectives of Islamic Banking order are: to Islamization of the society, to form (create) **Islamic Production Mode**, and "Homo Islamicus".

These two approaches to interest-free banking distinctly differ from one another. Establishing an Islamic bank according to the micro-approach means resolving the existing difficulties and differences between the proposed Islamic and the non Islamic institutional framework on the basis of Islamic shari'a laws (Islamic Code of law). The processes of loaning and borrowing should not be allowed when based on interest. Banks should be the source of finance for improvements in the living standards and conditions of Muslims under non-Muslim rule. This second need further implies competition with capitalist financial institutions which deal in usury. Until Islamic banks are fully established, capitalist banks are the only alternative, a kind of compromise in principles for Muslims.

The establishment of Islamic banks, using the micro-approach, in an arbitrary system of government is not acceptable to the requirements of Islamic teachings. It will not build the foundation of an Islamic economy where in Islamic banks can operate without resorting to usury. Thus, it is virtually impossible to establish an Islamic banking order in a non Islamic Economy (However, some banking officials disagree).

The existing so-called Islamic banks are compromising the rules of Islam in efforts to conform with non-Islamic economic principles in a non-islamic society.

The very idea of incorporating islamic economic concepts in secular institutions or banks is inappropriate and is against the Qur'an and shari'a. Those who desire usury-free banks in an islamic society will not liberate Muslims from an unjust economic system. Usury is forbidden in Islam, as are the unlawful practices which arise from it.

The macro-approach seeks to establish Islamic banking in a truly Islamic society. This means aiming beyond liberating a Muslim society from the evils and corruption associated with usury. Transforming a capitalist bank, as part of an overall process in making a society Islamic, involves, re-adjusting non-Islamic practices to be in accordance to Islamic principles. Socio-economic evils can be eradicated by implementing Islamic laws in all aspects of life. Islamic laws are interrelated. Assuch,

implementing one law lays the groundwork for the fulfillment of the spiritual and material goals set by Islam.

An Islamic Bank has a very vital role to play in the economic life of Muslims. A banks services can be made to conform to islamic laws on the basis of the following principles:

A) Banks should provide more than commercial banking services, adjusting their services charge rates to comply with the cost of services. When charging commission, a banking service should not become a cover for **any capitalistic exploitation**.

B) The services of banks should not harm the society, whose interests they are expected to serve.

C) The banking methodology should not contradict Islamic laws and the shari'a. It must conform precisely to Islam laws.

In order to overcome the shortcoming of capitalism, a redefinition of the term "capital" and the pertinent school of thought is necessary. **ISLAMIC BANKS MUST ELIMINATE THE EXPLOITATION OF MAN IN TERM OF THE PROFIT MOTIVE.**

Islamic Banks must have a moral orientation based on Islamic standards and principles. They must evolve ways and means of achieving economic growth without using the capitalistic banking system.

II. THE ACTIVITIES OF ISLAMIC BANKS

The activities of Islamic banks, when based on Islamical principles, will result in the following changer:

1) Deposits in Islamic banks can be guaranteed by the Islamic government's Central Bank, and no person or group will be discriminate against orexpited. Such safeguards allow the separation of any capitalistic accumulation or use of capital in the process of ensuring economic growth. The role of capital formation is best undertaken by the society as a whole, and an Islamic government should involve itself in it on behalf of the depositors. New wealth and power resulting from this activity would-belong to any individual or group, there by preventing the consolidation of the bank's resources and power in the hands of a few.

2) No interest should be charged by Islamic banks. Interest on loans or deposits is really an unearned wage given to depositors for the use of their money. Capitalistic theory recognizes this wage, or profit.

In Islam, wages are only lawful when they represent payment for services involving the performance of work for benefit of others, as specified on a contract basis. Moreover, capital does not necessarily refer to accumulated savings obtained from measurable work. Also, repaid loans do not mean any net addition to capital or to a society's resources. These examples illustrate the reasons for the prohibition of usury in Islam.

Unlike secular taxation, Islamic public financing emphasizes morality, benevolence and spiritual concern. Taxpaying Muslims and others are induced to overcome any selfishness and cold-heartedness. The Glorious Qu'ran assures Muslims in terms of ultimate spiritual recompense or rewards in following terms:

"Lo! those who read the Scripture of ALLAH, and establish worship, and spend out of that which We bestowed on them secretly and openly, they look forward to imperishable gains. (35: 29)".

The Qu'ran recognizes beneficial trading without loss of revenue. At the same time, it encourages people to help the poor and the needy in a spirit of not only charity but brotherhood, and in the way of God. Islam promotes a spirit of moral rectitude and goodwill even in commercial transactions.

That Islam promotes socio-economic well being evident from the traditional **Sandooghe-Garz-ul Hassanah** (public trust for interest-free loan) and the personal **Garz-ul Hassanah** dealings. These trust funds were, and still are, functioning in many Muslim countries in non-Muslim countries. People regularly deposit contributions or valuables without expending interest; evidencing their benevolence in this regard. Any largescale revival of these Islamic traditions will have a salutary impact on non-Islamic societies.

To implement the system of usury-free banking, an Islamic bank first announces its readiness to accept any amount of money or valuables as deposits. The basis of acceptance can be safe deposit only. Alternatively, the deposits can be considered as loans to the Islamic bank. In either case, no payment of interest is involved, and the deposits are returnable upon demand.

Deposits with an Islamic bank, which are invested in socio-economic plans, are exempt from wealth tax. This does not, however, entail any payment of wages by a bank to depositors for the latter's charitable acts.

III. THE OTHER OBJEKTIVES (AND CONCEPT) OF ISLAMIC BANK

What are the objectives of the Islamic bank? What are the means with which it can attain its ends, and consequently what are its characteristics and concept?

The objectives of Islamic banking it is not merely the elimination of RIBA, the banking system has to do much more than that. The interest free banking is only one element in the whole system of Islamic economics. This is a other criterion by which you can judge the structure of banking that has been suggested. Is the new structure which is to be proposed conductive for instance, to growth of savings? Will it increase the growth; what effect will it have on income distribution; how can it be conductive to meeting the basic needs of the society? The banking order has to be participant in this development process.

The first criterion is purely formal one-conformity with Sharialh, the second, is to see if it is in conformity with Islamic economic system, then the third criterion it so see if it is a viable structure at all or it will fall down by its weight.

Shortly, an Islamic Bank, has a multi-dimentional objectives. It is possible to identify some aspects.

The multi-dimentional function of an Islamic bank could be broken down to:

1. The ideological function
2. Rational and Investment function
3. Developmental and progressive function
4. The positive function
5. The social function... etc.

This framework will be studied accordingly.

1. The Ideological Function

An Islamic bank is not just a bank that does not operate under the interest mechanism, rather it is a bank based on certain economic philosophic principles. The key to such ideology is that God is the Creator and Ultimate Owner of the Universe and man, on earth, is his viceroy, or his vicegerent. Thus individual property is recognized but it is restrained to the teaching of God. (See principle no: 1, 2).

Islamic banks are not free to do as they please rather they have to integrate moral values with economic action (see principle no: 3). Property and, hence, money are social tools to achieve the social good. The objective of a bank should not be maximization of profits irrespective of the means but rather social-benefit-maximization. This objective is derived from the principle of socially-oriented function of wealth.

An Islamic bank should structure itself to serve the community along the lines prescribed by moral values, positive and negative teachings of Islam. Interest mechanism, in lending and deposit-taking is prohibited. Financing gambling casinos, night-clubs, pork projects... is prohibited. An Islamic bank is not merely an economic institution, but rather a religious-oriented institution for the good of man kind.

An Islamic bank should not conceive itself as an intermediate financial institution, but rather a more comprehensive one: an institution that is dedicated to foster economic welfare for the people coupled with moral values that has been accepted through the history of mankind: justice, cooperation, mercifulness, righteousness... etc.

One is tempted here, again, to cite some verses from the "Glorious Qur'an":

"O ye who believe Squander not your wealth among yourselves in vanity, except it be a trade by mutual consent." (**Women: 29**).

Man is ordered to accumulate and consume in a lawful way. The verse says:

"O mankind! Eat of that which is lawful and wholesome in the earth, and follow not the foot steps of the devil. Lo! he is an open enemy for you". (**The Cow: 168**).

Speaking to mankind has to be in a kind way:

"...and speak kindly to mankind?..." (**The Cow: 83**).

Kind behavior is valued more than giving property:

"A kind word with forgiveness is better than almsgiving followed by injury." (**The Cow: 263**).

Man is ordered to speak and greet others in a respectable way... even better than the original greeting. See this:

"When ye are greeted with a greeting, greet ye with a better than it or return it. Allah taketh count of all things". (**Women: 86**).

Mankind is ordered not to confound truth with falsehood... Man is ordered not to conceal truth:

“Confound not truth with falsehood, not knowingly conceal the truth”. (The Cow: 42).

The ideological function of Islamic Banking means, in practice that social-benefit-maximization as a guiding principle should be the objective. The ends and the means of economic activity should be good. Moral values cannot, and should be treated, or practiced separately or in a vacuum.

“Let not the vicissitude (of the success) of those who disbelieve, in the land, deceive thee (OMohammad).

(The family of Imran: 196, 197)

Islamic banks then are not fanatic institutions, but rather institutions constructed to achieve good ends of mankind.

2. The Investment Profit-Sharing Function

If traditional banks is constructed to lend those who need money with interest, an Islamic bank is constructed to supply money on profit-sharing principle. Without profit-sharing an Islamic bank cannot survive.

The abolition of interest rate from Islamic banking makes direct investment and equity financing a must. Thus, we would expect that an Islamic bank is not really, in a traditional sense, a commercial bank. It does not operate under the principle of trading-on-equity. One can say that an Islamic bank, is to a large extent, a savings-investment institution... through the Modaraba Contract. Islamic banks are not like ordinary investment banks but special kind working without the interest mechanism.

The prohibition of interest puts great responsibility on Islamic banks since it is necessary to make sound feasibility studies for numerous projects... much more than a traditional bank with the same size. Feasibility studies should be considered along the line of commercial profitability plus social profitability. This should constitute a problem in the functioning of Islamic banking, since there is a desire to achieve high returns to distribute high returns to public account holders with delegation to invest, and at the same time satisfy the social-benefit criteria of investment. This should lead us to the developmental nature of Islamic banking.

3. Developmental and Progressive Function

Before discussing the developmental nature of Islamic banking, it might be important to define the word "development". The word is usually used in economic sense, and does not include, social, psychological and mental development. But empirical research has proved that social, psychological and mental development must go in hand with economic development if it is to be effective.

An Islamic bank, being based in Islamic ideology for the benefit of mankind has to give serious consideration to the total development requirement for the community. An Islamic bank should take this social responsibility in the use of funds available.

Islamic banks direct-investment and joint-venture projects should be geared as far as possible toward:

- preserving natural resources and their best utilization.
- preserving productive capacities and their best utilization.
- emphasis on infra-structure projects needed for long term development.
- balance in different economic sectors.
- real full employment.

thus increasing the real per capita income.

The ideological nature of Islamic banks must not stay a theoretical concept. It should be put in practice for instance encouraging individuals to save as a way of life. Islamic banks should commit themselves to the psychological, social, mental aspects of development in the following areas:

- breaking tradition that are obstacles to development, traditions that do not serve mankind.
- breaking the passive role of man due to external pressures and submissiveness to impoverished dictators.
- breaking under-development related to misconceived ideas that have been put into logical stereotypes.
- breaking the prevailing submissive attitude and bad planning.
- strengthening the scientific thinking approach along with objective analysis thus breaking the prevailed false observations and impressions.

Islam came to show the right path and a good life. If an Islamic bank raises the "Islamic motto" it must tackle the problem of developing man... in his relation to God, in his relation to others... not only in his personal life but in business life.

4. The Positive Fonction

The investment - profit - sharing - developmental nature of Islamic banks makes it more imperative to act in more positive ways. An Islamic bank has to go out and search for new opportunities to invest funds available... opportunities other than just lending.

In the normal lending practices of commercial banks, one can easily see that banks usually wair for their customers. It is true that banks today introduce the concept of marketing to the field banking thus making them more positive in their action than before. But still, the lending function is still an intermediate action between those who supply funds (depositors) and those who demand funds for investment (borrowers).

5 The Social Function

Islamic banks, by the nature of being ideological, must be social, not just banks performing some special social functions or raising the molto of social responsibility.

The social nature of Islamic banking can be seen, or practiced, from several aspects: (1) rate of return - although based on profit and loss principle - must be higher than prevailing rate of interest since the bank does not trade equity. This high return for investment-account-holders is one way to decrease the inequality of the distribution of wealth. It is true that the investmen-account holder is not guaranteed to have a specific pre-determined rate, but the bank should make every conceivable effort to maximize profit subject to other restrains cited.

The return to the investment-account holder can be seen, in case of high profits, as a way to equilibrium of income distribution.

It is true that a commercial bank seeks out opportunities (for lending), searches out for information required for sound lending, takes necessary collateral... but still a bank is more or less sure that it will get its money back (the principal and the interest).

Since an Islamic bank does trade on its equity, it has to go out for joint-venture attitude... or even for direct long-term investment. This

risk-taking endeavour makes it necessary for making sound feasibility studies.

On the other hand, a depositor cannot have a fixed pre-determined rate of return on his deposited money (with delagation to invest). The depositor himself cannot be passive. He has to be alert of the soundness and good management of the banks he chooses.

Big depositors, in the case of Islamic banking may prefer to go into business rather than just waiting for a return. Thus we should expect a positive attitude on the part of depositors.

Islamic banking should, then, encourage positive attitude among depositors and among a large number of the society. The prohibition of interest will not make people waiting for the interest of their capital. A dynamic positive force activitates the society... thus creating positive investors, positive attitudes of life. That makes the Islamic bank satisfy the requirement of developing the the psychological-social-mental aspect of society.

The social nature of Islamic banks can also be seen from the "wealth-tax" explained earlier as AL-ZAKAT. We have said earlier that the basic orientation of an Islamic economy is mutual sharing of the community's income between the affluent and the have-not's. While AL-ZAKAT is compulsory, voluntary spending is encouraged (Sadaqah). These forms of transfers may be described as social insurance.⁷

An Islamic bank may establish a Zakat-Fund administers sources and uses of funds according to Islamic regulations.

CONSLUSION

Most of Islamic countries are setting Plans and Programs on quest for economic and social development. Such developmental activities require the establishment of dinamic institution that lead the efforts of socio-economic change. Moreover, success in this endeavor demands the leadership's realism, Ideology, understanding, dedication and inspiring candor in communicating to the people an awarenness of the institution's role and expectations and anawareness of the price of development so

⁷ for a detailed study of the economics of Zakat see:

F. Faridi, "Zakat and Fiscal Policy", *Studies in Islamic Economics*, ed., Khurshid Ahmad, International Centre for Research in Islamic Economics, King Abdul Aziz University, Jeddah, and the Islamic Foundation, U.K., 1980.

that they to can play their essential part in what must be a truly national effort.

However, if the developmental nstitutions are seperated from the environment where they operate, failure will be the disappointing result for the leaders of these institutions. So they should consider the cultural context in which they operate, reflect the needs and aspirations of the people, and be consistent with their beliefs and spiritual virtues.

Islamic Bankinkg respresents a new approach to finance that affords special attention to development and to better social harmany structure. In the Western banking system there is no evaluation of the real ability or potential of the customer. The deciding factor is his credit-worthiness, the project and the man himself come later. In a real Islamic Bank there is a wider spreading of finance providing a better opportunity to those who are able to work hard. Entrepreneurs who can establish new projets are welcomed as partners not borrowers.

For the further development of Islamic banking much depends on central bank authorities In Muslim countries, who must ensure that Islamic banks conform to the following principles, dictated.

both by Islam and national interests.

A. The clear avoidance of usury in debts and sales. Other wise, banks will invest their funds in the international markets where the developed methods and techniques rely on interest. Usury of sales in forward exchange is no less a danger than interest itself.

B. The modern understanding of banking as the art of usnig money and the national needs as a strategy. An Islamic bank must not be an additional number to the existing banks. It must be distinguished in it function and role.

C. Islamic Banks, must obey the general rules of the central bank. No exception from cash reserves or liquidity requirement can be allowed. Foreign exchange dealings must be controlled and directed in conformity with the national developments and economical needs of each individual muslim country. If prudence prevails in good faith, then the future of Islamic Banks is assured.

REFERENCES

- Ahmed M. A. Al Najjar, *Banks Without Interest: Arab Society in Transition* (Arabic Translation of R.K. Reedy's book), Sudanese House, 1970.
- Z. Ahmed, M. Iqbal-M.F. Khan, *Money and Banking in Islam* (Institute of Policy Studies, Islamabad), 1983.
- Ahmed Safiel Din, *Studies in Islamic Economics* (In Arabic), Khartoum, 1978.
- Eisa Abdu, *Banks Without Interest* (Dar Al-I'tisam, 1977-in Arabic).
- Khurshid Ahmad, *Economic Development in an Islamic Framework*, Leicester 1980.
- Y. Firestone, "Production and Trade in an Islamic Context", *IJMES* vol. 6, 2 (1975).
- H. Gerber, "The Muslim Law of Partnerships in Ottoman Court Records", *STUDIA ISLAMICA*, 1981, vol. 53.
- Muazzam Ali: "Islamic banking comes of age", in *Economic Banking, Arabia, Arabia*, August, 1985, p. 60.
- N.H. Naqvi, H.U. Beg, Rafik Ahmet, M.M. Nazeer: *An Agenda for Islamic Reform.*, May, 1980, Pakistan Institute of Development Economics, Islamabad.
- J. Schacht, *An Introduction to Islamic Law*, Oxford: Clarendon Press, 1982.
- M.N. Siddiqi; *Shirkat aur mudarabat ke shar'i usul*, Islamic Publication, Lahore, 1961.
- A. Udovitch, *Partnership and Profit in Medieval Islam*, Princeton University Press, 1970.